fi compass ERDF

Factsheet
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ERDF loan financial instruments

European Commission

European Investment Bank

ERDF loan financial instruments

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Glossary

Financial instrument: a form of support delivered via a structure through which financial products are provided to final recipients.

Beneficiary: The body that implements the holding fund or, where there is no holding fund structure, the body that implements the specific fund or, where the managing authority manages the financial instrument, the managing authority.

Body implementing a financial instrument: a body, governed by public or private law, carrying out tasks of a holding fund or specific fund.

Financial intermediary: A specialised financial institution providing credit and guarantee products to final recipients of a financial instrument.

Final recipient: a legal or natural person receiving support from the Funds from the financial instrument.

Holding fund: A fund set up under the responsibility of a managing authority under one or more programmes, to implement one or more specific funds Art. 2(20) CPR.

Managing authority: A national ministry/regional authority/local council, or another public or private body responsible for the efficient management and implementation of an operational programme.

Shared management: Member States are entrusted by the EC with the implementation of operational programmes and the allocation of funds to final recipients (e.g. SMEs, natural persons, municipalities, etc.).

Specific fund: A fund through which a managing authority or a holding fund provides financial products to final recipients Art. 2(21) CPR.

Abbreviations

Abbreviation	Full name
CF	Cohesion Fund
CPR	Common Provisions Regulation
EC	European Commission
EE	Energy Efficiency
EIB	European Investment Bank
EIF	European Investment Fund
ERDF	European Regional Development Fund
ESIF or ESI Funds	European Structural and Investment Funds
ESCO	Energy Service Companies
EU	European Union
FoF	Fund of funds
ICT	Information and Communications Technology
JESSICA	Joint European Support for Sustainable Investment in City Areas
MA	Managing authority
MS	Member State
NEB TDM	New European Bauhaus Territorial Development Model
PO	Policy Objective
RDI	Research, Development and Innovation
RE(S)	Renewable Energy (Sources)
SME(s)	Small and medium-sized enterprise(s)
TO	Thematic Objective

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01 Executive summary

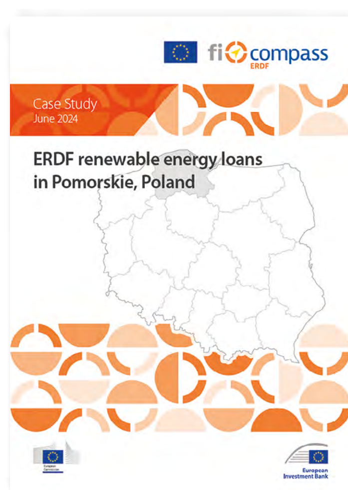
This factsheet aims to present key features of loan financial instruments, together with industry best practice, to support managing authorities and other fi-compass stakeholders seeking to implement loan financial instruments in the future. The factsheet builds on the various fi-compass publications deemed to be relevant for the subject. For further reading, the access to these publications is highlighted in the current document.

Loan financial instruments can offer an efficient and sustainable form of public support, especially when lending banks face liquidity issues resulting in a shortage of the lending capacity. Loan financial instruments under the European Regional Development Fund (ERDF) provide a simple and flexible financing solution that can be tailored by managing authorities to meet their local sectoral needs and to achieve public policy goals in the target sectors.

According to the fi-compass Gap analysis[1], the financing gap in the EU economy remains high for small and medium-sized enterprises (SMEs), the energy efficiency sector as well as with respect to other priority sectors in the 2021-2027 period. In particular, smaller and younger SMEs as well as innovative companies and those active in new sectors, such as circular economy generally face more difficulties in accessing debt financing, due to the lack of credit history and the lack of tangible assets that could be offered as collateral.

Loan financial instruments, by providing funded risk-financing to intermediaries, improve the banks' lending capacity and appetite for riskier projects. In case of default, the loss to be borne by the financial intermediary would be reduced in line with the risk-sharing rate of the instrument. At the same time, in return to the loss protection (that is often provided free of charge) the banks are obliged to improve the financing conditions towards the final recipients, usually in the form of lower interest rates and reduced collateral requirements and potentially other benefits as well, such as longer maturity, extended grace period or reduced transaction costs.

Renewable energy loans in Pomorskie (Poland)



The Renewable Energy Sources (RES) Loan Fund launched in 2019 under the ERDF Regional Operational Programme 2014-2020 in Pomorskie, Poland. It was managed by the European Investment Bank (EIB) as holding fund manager and implemented by Pomorski Fundusz Pożyczkowy (PFP, Pomorskie Loan Fund). The ERDF RES loans financed 137 diverse RES projects in the region, ranging from photovoltaics to biogas installations. Final recipients benefited from attractive loan terms such as reduced interest rates, extended repayment periods and absence of fees.

1 fi-compass Gap analysis for small and medium-sized enterprises financing in the European Union. Final report. December 2019.

Loan instruments supported by ERDF resources can be used to finance a wide range of projects, including energy efficiency (EE) (see fi-compass model EE financial instrument), urban development (see New European Bauhaus Territorial Development Model) and investments in various sectors. For example:

- In the renewable energy (RE) sector, projects that are characterised by capital intensity and uncertain return on investment;
- In the environment sector, projects that do not generate direct streams of revenues and generally require many years to break even;
- In the Information and Communications Technology sector, projects in sparsely populated areas that are characterised by high investment costs per capita;
- In the transport sector, projects implemented by smaller municipalities requiring a critical mass to access financing in acceptable conditions;
- In relation to Research, Development and Innovation (RDI), innovative projects reaching their commercialisation phase and requiring financing to support the delivery of the new product to the market.

Loan ERDF financial instruments have been used in combination with grant in sectors including EE, SME finance and RDI. In the 2021-2027 programming period, the use of combination is incentivised with the possibility to combine grants (such as interest rate subsidies, capital grant, capital rebate, convertible loan or in the form of technical support) and financial instruments in a single operation and with both types of support provided by the same financial intermediary.

The fi-compass model financial instrument with a grant component to support energy efficiency

A loan financial instrument is the basis for the fi-compass model combined financial instrument for energy efficiency published in 2022.

The model provides a non-exhaustive insight into the potential for MAs to use the new flexibilities in Article 58 of the Common Provisions Regulation (CPR).

Energy efficiency investments can be structured in such a way that the cost of the works is at least partially covered by savings on energy expenses. In practice, grants are often necessary for funding parts of energy projects, particularly those which have low or negative internal rates of return, or if needed for social reasons or deep renovation purposes.

For the overall success of the instrument, a number of factors should be kept in mind, for which examples of the past can provide important lessons learnt. Main success factors include:

- Focus on design, with an instrument that is demand-driven (with well-defined policy objectives and sufficient market absorption capacity) and flexible to adapt to changing circumstances;
- Building a strong partnership with the different actors and aligning their interests;
- Knowledge-sharing between the stakeholders in order to structure the instrument in a way that complies with regulatory requirements and meets the needs of the market as well.

Blackshape – innovative aviation company supported by an ERDF loan financial instrument (Italy)

The Italian Ministry of Universities and Research set up loan and equity financial instruments with ERDF resources in the 2014-2020 period to finance innovative companies based in Southern Italy.

Blackshape, an SME based in the Apulia region of Southern Italy, has developed an innovative aircraft platform for patrol, reconnaissance and training functions. The ERDF loan financial instrument supported the company with financing of EUR 1.9 million which enabled it to develop a new product line and expand its workforce.

02 Introduction to ERDF loan financial instruments

2.1 Definition of loan financial instruments

A loan is the most common form of financing for businesses across the EU, with over 80% of businesses surveyed in 2022 indicating it is relevant to them[2]. A loan is defined by the European Commission[3] as:

'An agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time.'

Loan finance can include credit lines, overdraft and credit card facilities, leasing or hire purchase and bank loans. Typically, loans are commonly used by businesses to finance investment in new equipment or other assets and working capital, meeting ongoing liquidity needs as well as supporting the development and modernisation of businesses.

In addition to business financing, loan finance underpins investment by both public and private building owners (including individuals) in property, infrastructure and urban development. Investment in the EU's green transition, including energy efficiency and renewable energy projects is predominantly financed through loan instruments.

Finally, new businesses and entrepreneurs utilise loan financing. Seed loans, provide start-ups with initial capital to enable them to start to develop their products and business, paving the way for future investment from venture capital funds. Microloans from microfinance institutions, often coupled with non-financial support in the form of business development services, can support entrepreneurs, including those from vulnerable groups, to start their own small businesses.

2.2 Technical features of a loan

There are a number of features of a typical lending product which together form the terms of the loan provided by the body implementing the financial instrument to the final recipient.

Principal

The amount of the loan advanced to the final recipient is termed the principal. Under the loan agreement it is the agreed sum of money paid by the body implementing the financial instrument to the final recipient.

Interest

The interest is the price paid by the final recipient for the loan of the principal. It is typically calculated by reference to an annual percentage of the amount of the loan (the interest rate). The interest rate is typically determined by the financial institutions based on various factors, such as the final recipient's creditworthiness, the duration of the loan and prevailing market conditions.

2 European Commission Survey on the access to finance of enterprises (SAFE). Analytical Report 2022.
3 Guidance for Member States on Financial Instruments – Glossary.

Maturity

The duration of the loan, usually expressed as a period of years. The final recipient is obliged to repay the principal and any outstanding interest at the end of the term.

Repayment frequency

The terms for repayment of the principal and interest. For most loans, repayments are amortised so that the principal and interest are repaid in pre-defined instalments throughout the term of the loan. This could be done a monthly, quarterly or yearly basis.

Amortisation profile

There are several types of loan amortisation, which refer to the way in which loan payments are structured over time. Some of the most common types of loan amortisation include:

- **Linear:** it involves paying off the same amount of the loan principal with each payment, while the amount of interest decreases over time as the outstanding principal balance decreases.
- **Annuity:** it means regular payments of equal amounts throughout the loan term. These payments consist of both principal and interest, with the proportion of each changing over time.
- **Balloon/Bullet:** it involves making lower monthly payments throughout most of the loan term, but then making a large payment at the end of the term, and/or following achievement of specified milestones to pay off the remaining principal balance.

Grace period

A short period at the beginning of the term of the loan during which repayment of the principal and/or interest is suspended. For example, a loan for EE work may include a grace period to suspend repayment of the loan until the work is complete.

Collateral

Assets that are pledged by a final recipient as security for a loan. In the event that the final recipient defaults on the loan, the body implementing the final instrument is entitled to recourse against the asset for all sums outstanding.

Transaction costs & fees

Loans may include various fees associated with the transaction, such as origination fees, loan servicing fees, late payment fees, prepayment fees, etc.

Default

When the final recipient has failed to meet any payment obligation under the relevant loan contract and such failure has continued for a period of time defined by the financial institution according to its internal risk policy. It could result in the foreclosure of the collateral provided by the final recipient.

Microfinance

Financial products (typically provided by commercial banks or microfinance institutions) designed to provide small loans, savings accounts and other financial services to low-income individuals and small businesses.

Revolving credit line

A loan transaction to a final recipient that can use, on a revolving basis, the financing available for a specified period through one or more drawdowns and repayments up to the credit limit amount, including by settling obligations arising from a letter of credit.

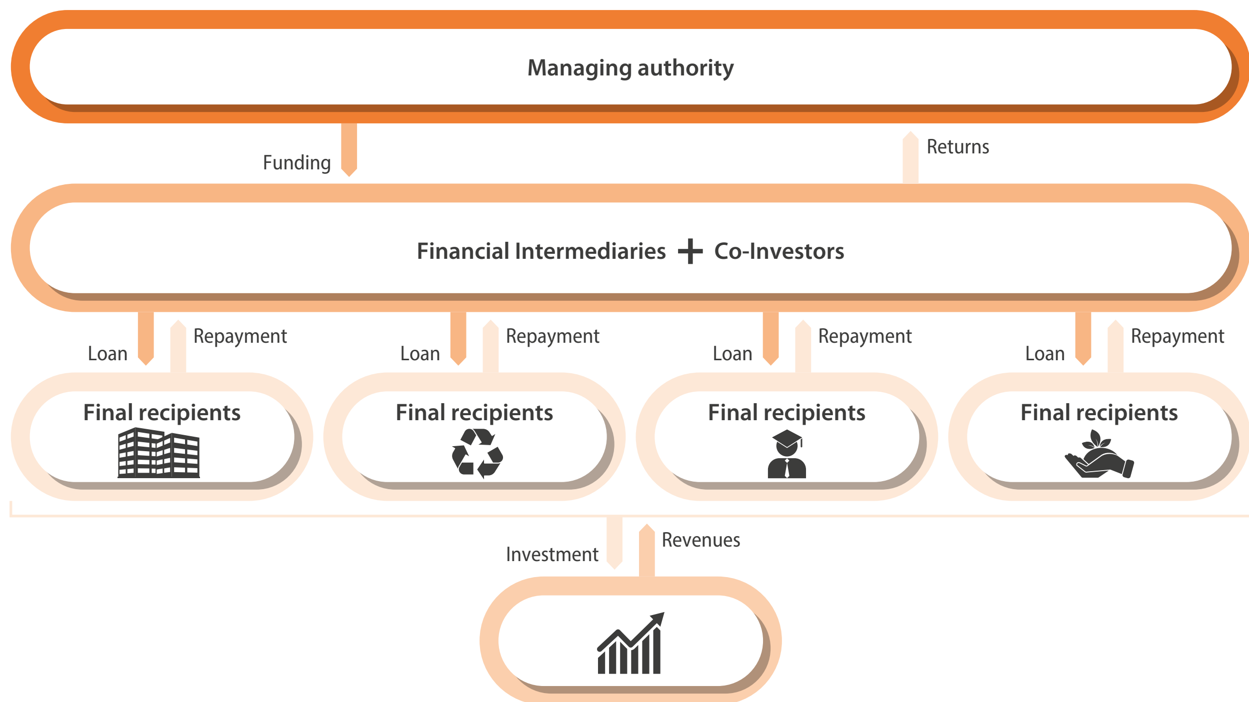
2.3 Purpose of ERDF loan financial instruments

The fi-compass publication, 'Financial Instruments products', provides an introduction to loan financial instruments. Figure 1 shows how a typical loan works.

ERDF resources are committed to a financial intermediary by the managing authority, either directly or through a holding fund. Co-investment is secured either from the financial intermediary or other investors and the resources are then used to finance loans to eligible final recipients.

Three loan financial instruments featured amongst the off-the-shelf models[4] published by the European Commission in the 2014-2020 programming period: a portfolio Risk Sharing Loan; a Renovation Loan; and an Urban Development Fund. The European Commission published in 2022 the New European Bauhaus Territorial Development Model financial instrument[5] which features a loan financial instrument combined with grant.

Figure 1: Structure of a loan financial instrument



4 COMMISSION IMPLEMENTING REGULATION (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments; and COMMISSION IMPLEMENTING REGULATION (EU) 2016/1157 of 11 July 2016 amending Implementing Regulation (EU) No 964/2014 as regards standard terms and conditions for financial instruments for a co-investment facility and for an urban development fund.

5 COMMISSION STAFF WORKING DOCUMENT New European Bauhaus territorial development model (NEB TDM) financial instrument (SWD(2022) 172 final).

In addition, fi-compass published a model for a financial instrument with a grant component to support energy efficiency[6] and a factsheet on setting up a microfinance financial instrument[7].

In all cases, ERDF loan financial instruments provide a flexible financing solution that can be tailored by managing authorities to meet their local sectoral needs. Some of the benefits that can be offered by ERDF loan instruments include:

- **Lower interest rates:** ERDF programme resources can be committed at zero cost and this benefit is then passed to final recipients. As a result, the interest rate payable on the loan will reflect only the interest payable in respect of the co-investment contributed by other investors, providing a significant discount when compared with the interest rates available on the market;
- **Reduced collateral requirements:** Typically lenders will require the final recipient to pledge assets such as property, receivables or investments as security for the loan. This can be a significant barrier for some borrowers who may not have suitable assets to satisfy a market-based lender. The reduction of the collateral requirements may help address a market failure and unlock investment amongst target final recipients;
- **Longer loan duration:** In order to make low-cost loans affordable, lenders can offer loans with a long duration. This reduces the monthly payments, thereby making the loan attractive to potential borrowers. For example, for energy efficiency investment, a longer loan duration may result in a monthly repayment below the monthly savings in terms of energy costs;
- **Extended grace periods:** Another flexibility offered to borrowers in an extended grace period, delaying the date on which the principal (and in some cases principal and interest) starts to be repaid. This can provide an effective way of financing the installation of new equipment, allowing the repayments to be delayed until the final recipient is benefiting from savings and/or revenue generated by the investment;
- **Combination with grant:** Loan financial instruments can be combined with grants in a single operation or two separate operations. This allows additional support to be provided to final recipients alongside the loan including technical assistance; interest rate subsidies, to reduce the cost of the part of the loan finance by the co-investor(s); Investment grant to meet part of the investment cost; and capital rebates payable following successful achievement of a target. The use of grants in combination with loan financial instruments is needed where investments are not capable of generating sufficient economic returns or cost savings to be viable without additional support.

The flexibility of loan financial instruments has resulted in their use in a wide range of different settings including access to finance for SMEs, financing EE measures in public and private buildings (including residential), microfinance, investment in renewable energy (RE) and urban development.

6 fi-compass model for a financial instrument with a grant component to support energy efficiency.
7 Setting up a microfinance financial instrument.

Slovak Investment Holding – multi sector financial instruments in Slovakia

The holding fund set up in Slovakia managed more than EUR 1 billion of resources through financial instruments in the 2014-2020 programming period. The experience in Slovakia allowed different types of products to be used to support final recipients across a range of sectors.

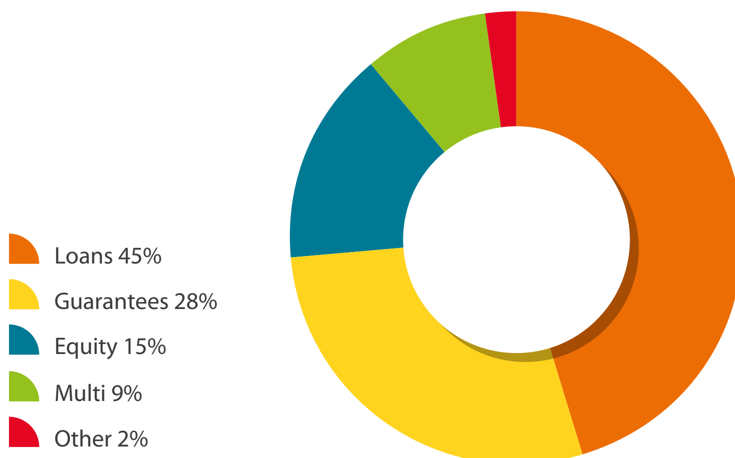
Loan financial instruments were particularly important in the energy efficiency and waste management sectors, supporting projects with a higher risk profile due to their relatively large size and heterogeneous nature. Loan financial instruments were also used to support projects in the transport, cultural and social economy sectors.

The product offering of the holding fund includes both standard instruments (such as portfolio risk-sharing loan instruments, potentially complemented by interest rate subsidy element) as well as tailored solutions for specific market needs. For example, a direct loan investment model was developed to support the development of the Energy Service Contracts (ESCO) sector to undertake energy efficiency retrofitting works to public buildings and SMEs as part of the country's response to the climate crisis.

2.4 The growth of ERDF debt financing

The data published by the European Commission on the use of financial instruments in the 2014-2020 programming period, for the period ending December 2022[8] shows that loan financial instruments are the most common product type adopted by Member States. Approximately 45% of all ERDF/CF programme resources committed to financial instruments were made to loan financial instruments, representing a total of approximately EUR 13.4 billion of EU resources.

Figure 2: Programme amounts committed to FIs by product, as of end 2022



8 Financial instruments under the European Structural and Investment Funds. Summaries of the data on the progress made in financing and implementing the financial instruments for the programming period 2014-2020 in accordance with Article 46 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council. Situation as of 31 December 2022.

The European Commission's data shows that loan financial instruments achieved a median leverage rate of 1.3 meaning that for every euro of ERDF committed to a financial instrument a total of EUR 1.30 was paid to the final recipient, including additional investment from other sources. If this rate is applied across the entire EU portfolio of loan financial instruments, it can be estimated that the EUR 13.4 billion of ERDF loan financial instruments will mobilise a total of EUR 17.4 billion.

Hector le collector – loan financial instrument support for green start-up

Based in Toulouse, the start-up Hector le collector offers a waste recycling service whereby urban food waste is collected and used to create bio-energy.

The company was set up using loan finance contributed by Créalia, a specialised seed loan fund based in the Occitanie region of France. Créalia helps entrepreneurs launch innovative businesses with a high local impact in the whole Occitanie region, using ERDF resources contributed through the FOSTER TPE-PME Holding Fund set up by the region.

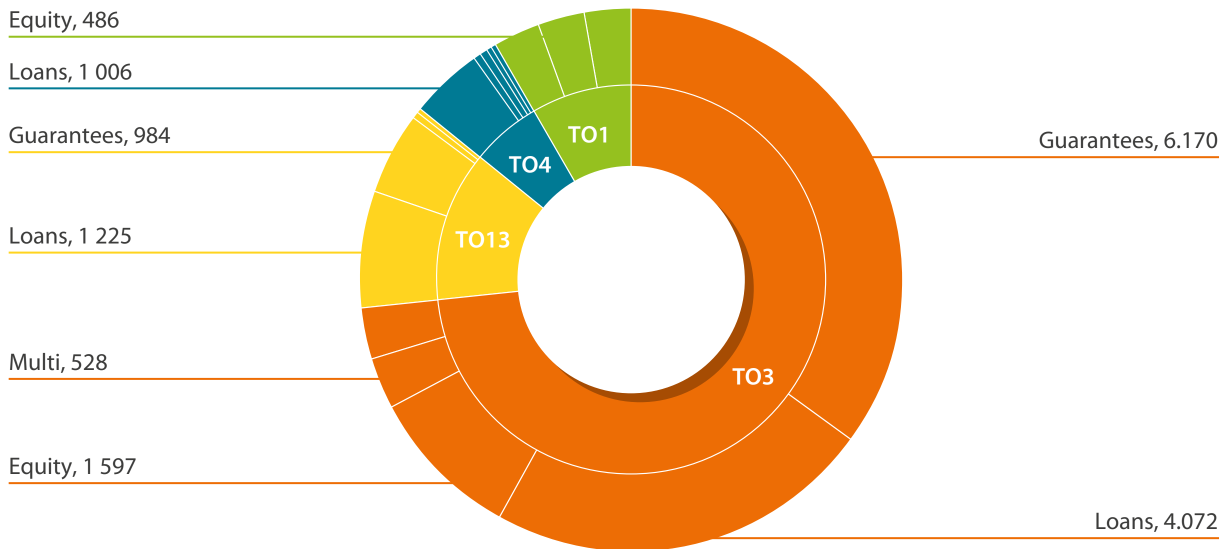
Although the leverage rate of loan financial instruments (1.3) is lower than that of guarantees (5.2) and equity (2.0), the rate of repayment is significantly higher for loan financial instruments. Up to the end of 2022, a total of EUR 3.2 billion of resources had been repaid to financial instruments, of which, EUR 2.9 billion (ca. 91%) related to loan financial instruments. Of the amounts repaid approximately EUR 400 million (or 14%) of the repaid resources had been reinvested in further final recipients.

The average loan provided through ERDF loan financial instruments was approximately EUR 45 000, although there was significant variance between Member States (from EUR 15 000 in Greece to EUR 1.1million in Bulgaria) and between different thematic objectives.

The main sectors in which loan financial instruments were deployed were:

- TO3: SME competitiveness – EUR 4.1 billion ERDF committed out of a total EUR 15.5 billion ERDF commitment to financial instruments in the sector (ca. 26%);
- TO13: Fostering crisis repair and resilience under REACT-EU – EUR 1.2 billion out of a total EUR 2.4 billion ERDF commitment to the sector (ca. 50%);
- TO4: Low-carbon economy – EUR 1 billion committed out of a total EUR 1.4 billion ERDF commitment to financial instruments in the sector (ca. 71%); and
- TO1: RDI – EUR 0.5 billion out of a total EUR 1.3 billion ERDF commitment to the sector (ca. 38%).

Figure 3: ERDF and CF committed by TO and financial product



The fi-compass report 'The potential for investment in energy efficiency through financial instruments in the European Union', sets out how the European Commission estimate that the financing gap in the energy efficiency sector is approximately EUR 185 billion per year, with the largest need (EUR 115 billion) being in the residential sector. The accompanying detailed Member States analysis report sets out the estimated financing needs for each country in the EU. The report concludes that given the revolving nature of EE projects and in order to create leverage and to crowd in other investors, the use of financial instruments in the EE sector should be prioritised. Financial instruments, in combination with grant, can support investments in residential, public and commercial buildings, including through the use of ESCOs, as well as supporting businesses investing in more sustainable products and processes.

Similarly, the fi-compass report into SME financing needs, 'Gap analysis for small and medium-sized enterprises financing in the European Union', identifies a debt financing gap for SMEs at the EU level of EUR 176.7 billion. The report goes on to break down this analysis, providing an estimate of the financing gap for loan finance for SMEs in each Member State.

Although the data for the two fi-compass reports relates to the period before the COVID-19 pandemic, the general methodology and trends identified in the report are considered to be robust and provides an indication of the continued importance of ERDF loan financial instruments in the 2021-2027 programming period.

The fi-compass report 'Stocktaking study on financial instruments by sector. Progress to date, market needs and implications for financial instruments', goes on to consider how loan (and other) financial instruments can support other priority sectors in the 2021-2027 period including: renewable energy; urban development and transport; environment (including air, water and waste); ICT infrastructure; RDI and SMEs.

Residential energy efficiency financial instruments (Lithuania)

The managing authority (Ministry of Environment) and the EIB as fund of funds manager, have launched the loan instrument in partneship with the government agency BETA, providing residents with soft loans (low cost, long term, low interest, without collateral) to carry out renovation works in the apartment blocks to improve their energy efficiency.

An integrated project delivery process has been established which allowed the works to be delivered in a single package for the whole building, with the contractor receiving payment directly from the financial intermediary on behalf of the residents of a single block (i.e. final recipients).

The works undertaken typically included the replacement of doors and windows, exterior cladding of the building and installation of new more efficient heating systems.

The instrument was implemented in combination with grants, both in the form of technical support, interest rate subsidies and (mostly from non-ESIF resources) as capital rebates.

03 Loan financial instruments: a market perspective

3.1 Debt financing in the real economy

Loan instruments can address both medium and long-term needs for investments (mainly for investments in infrastructure or fixed assets) and short-term needs for working capital. As a consequence, debt finance can be deployed across a range of different sectors, providing simple, flexible finance for final recipients across numerous sectors.

The Financial Stability Board report highlights how "bank lending remains the prevalent form of external SME financing in almost all jurisdictions. There is significant heterogeneity across jurisdictions in the types of banks that provide SME financing, largely reflecting the structure of the banking sector"[9]. However, banks' lending capacity has been affected negatively by the current situation of the European banking sector that has to implement the Basel III reforms (that involves a 25%-30% increase of the banks' capital). Furthermore, the prevailing financial landscape, generally characterised by increased interest rates (since 2022) has implications for banks' ability to extend loans to SMEs, due to higher borrowing costs for banks, reduced demand for loans from SMEs and potential pressure on profitability margins.

Access to finance remains a critical challenge for SMEs, stemming from a combination of market failures and broader financial market dynamics. Market failures, such as information asymmetry and transaction costs associated with small-scale loans, significantly hinder SMEs' ability to secure bank lending. For instance, banks often struggle to assess the risk of SMEs (in particular highly innovative companies), making it difficult for them to access financing even at high interest rates. Additionally, small-scale borrowing can result in disproportionately high interest rates due to incorporated transaction costs, posing a significant barrier to SMEs seeking capital.

Moreover, regulatory requirements related to capital adequacy ratios have led to a decline of lending, particularly for higher-risk businesses. Debt financing solutions can provide capital relief by sharing the risk with banks, thereby allowing lenders to expand their lending activities.

Furthermore, economic fluctuations and liquidity issues in financial markets can exacerbate the challenges faced by SMEs in accessing finance. Short-term fluctuations in liquidity and inadequate management practices within SMEs can create uncertainties and affect the availability of credit. Debt instruments, especially loan co-financing arrangements, can provide a stable source of funding, mitigating liquidity risks for banks and ensuring a more consistent flow of credit to SMEs. Additionally, debt instruments contribute to building a robust funding ecosystem that supports the higher-risk spectrum of the economy, including emerging sectors that may otherwise struggle to access traditional financing avenues.

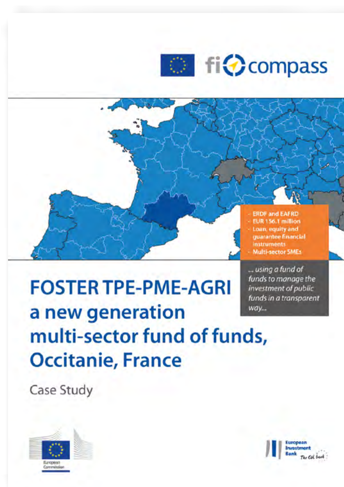
9 Financial Stability Board, Evaluation of the effects of financial regulatory reforms on Small and Medium-sized Enterprise (SME) financing, 29 November 2019 (p.1).

Loans provide the main source of finance for EE and RE investments, providing long-term finance for projects tailored to the needs of different final recipients. Long-term, low-cost loans, often in combination with grants, can provide a financing solution whereby the annual cost of finance is equal to or less than the savings made by the final recipient. Products can be developed to target specific sectors such as residential properties (financing individual home-owners or homeowner associations); public buildings (through public sector loans); and commercial property (through corporate or property development loans). Loans to businesses also provide the investment they need to support their transition to low-carbon and digital operations.

Microcredit is a type of loan product that is very small in value (typically less than EUR 25 000) and are normally provided to final recipients that do not have access to financing in the market, due to lack of collateral or credit history. The final recipients applying for a microcredit might also have little experience or lack specific skills in running a business. Non-financial support in the form of business development services including coaching, mentoring, training, might be a relevant complementary service offering in such cases.

Seed loans typically finance individuals or young innovative SMEs in their seed, pre-seed and/or start-up phase, where the risk is the highest, and where the resources to finance the investments are difficult to find. Financed projects could include, for example, market feasibility studies, development of prototypes and beta versions, filing of patents, etc.

Seed loan instrument (Occitanie, France)



The Seed loan instrument is a funded risk shariang loan product established under FOSTER, a fund of funds established in the region of Occitanie, France and managed by the European Investment Fund (EIF).

The financial size of the instrument amounts to EUR 12 million, with EUR 6 million committed by the fund of funds and the same amount of co-investment commited by the financial intermediary Créalia.

It is expected that additional investment to the companies through investors crowded-in would secure further co-investment of a minimum of EUR 12 million, thus mobilising a total investment volume of at least EUR 24 million.

The target final recipients are innovative SMEs, based in the Occitanie region seeking to strengthen their financial structure to support their development.

3.2 Loan instruments vs other financial products

Loan financial instruments are also referred to as 'funded' financial instruments as the ERDF programme resources are used to directly fund the loans to final recipients. In contrast, guarantee financial instruments are known as 'unfunded' financial instruments as the ERDF resources are used to provide a guarantee to a bank (or other institution) which in turn provides loans to final recipients out of its own resources.

Both types of financial instrument have advantages and disadvantages compared to the other. Funded products such as loans require more initial resources than unfunded products such as guarantees. The leverage potential of loan instruments is lower than that of unfunded instruments and they are less adequate if the market failure to address is related to the low risk appetite of the banks.

On the other hand, loan instruments could be the instrument of choice for managing authorities if scarce liquidity or required capital adequacy ratios are more of an issue for the banking sector. In such cases, the funded nature of the product allows to increase the lending capabilities of the banks and thus improving access to financing for the targeted final beneficiaries. Loan instruments are more advantageous than guarantees in terms of the revolving effect as well. The reflows, in line with the predefined repayment schedule of the loans, become available for re-investment sooner than in the case of unfunded products.

For further information on the pros and cons of each financial product, see fi-compass: 'Financial Instrument Products'.

Figure 4: Comparison of financial products

	Loan product	Guarantee products		
	Portfolio Risk-Sharing Loan	Capped Guarantee	Uncapped Guarantee	Individual Guarantee
Portfolio	Financial Intermediary; Risk sharing	Financial Intermediary; Expected loss	Financial Intermediary; Expected loss	N/A
Leverage	Low	Highest	Depending on other investors	High
Risk profile	Low	High	Higher	High
Transfer of benefit	Highest	High	Depending on the guarantee fee	High
Reflows	Fast	Slowest	Slowest	Slow

In comparison with equity/quasi-equity products, loan financial instruments offer a lower return. Equity funds also tend to provide non-financial support to the businesses they support through mentoring, participation in board meetings and strategic decision making and developing a network of customers and suppliers. On the other hand, loan financial instruments have the potential to reach a far greater number of final recipients and are well understood products attractive to different types of final recipient. In particular, whilst equity/quasi-equity finance is suitable for financing companies with high growth potential, loan financial instruments can support businesses of all types, providing accessible finance that does not dilute the ownership structure of the final recipient.

TEPIX Business Restart' Action (Greece)

The 'TEPIX Business Restart' Action was set up under the TEPIX holding fund, co-funded by the ERDF through five Greek Operational Programmes in the 2007-2013 programming period. The financial size of the instrument amounted to EUR 567.5 million, 50% of which was contributed by the ten selected financial intermediaries.

The financial instrument provided loans across Greece to SMEs in a crisis-hit market, at a time when liquidity and access to commercial loans was very limited. Loans were designed to cover both business investment projects and working capital needs with interest rates that were half of market rates.

In total, by the end of the availability period in 2017, 4 574 loan contracts had been signed (ca. 72% of which were for working capital). After the closure of the 2007-2013 programming period, as a result of the revolving nature of the instrument, EUR 192 million returned to the State was again reinvested in the TEPIX Fund.

04

Loan financial instruments: key market features

4.1 General characteristics of loan instruments

Loan financial instruments offer several features that make them appealing and practical investment vehicles. One notable aspect is their ability to decrease exposure for investors. By spreading investments across multiple projects or loans, these instruments reduce concentration risk and limit the impact of individual defaults on overall investment portfolios. This decreased exposure allows investors to participate in a broader range of projects and diversify their portfolios without significantly increasing their risk-taking capacity, particularly beneficial for SME loans where individual loan exposure is minor relative to the entire portfolio in that asset class.

Additionally, loan financial instruments provide enhanced liquidity compared to direct lending arrangements. Pooling funds from multiple investors facilitates easier entry and exit into investments, offering investors greater flexibility and improved liquidity management capabilities.

Another distinct feature of loan financial instruments is their stable returns due to their fixed-income nature. These instruments offer predictable income streams that can be appealing to investors seeking regular cash flows with minimal volatility. While risk sharing may not directly improve risk profiles, it can lead to risk-adjusted returns that align with investors' risk tolerance levels, making the instruments attractive from a risk-reward perspective.

Furthermore, loan financial instruments provide access to diverse investment opportunities across various sectors and geographical regions. Investors can select investments based on their risk appetite and preferences, allowing for effective diversification and risk management strategies. Transparent risk assessment processes and clear reporting mechanisms enhance investor confidence and enable better evaluation of the risk-return dynamics associated with each investment opportunity.

4.2 The risk-sharing loan model

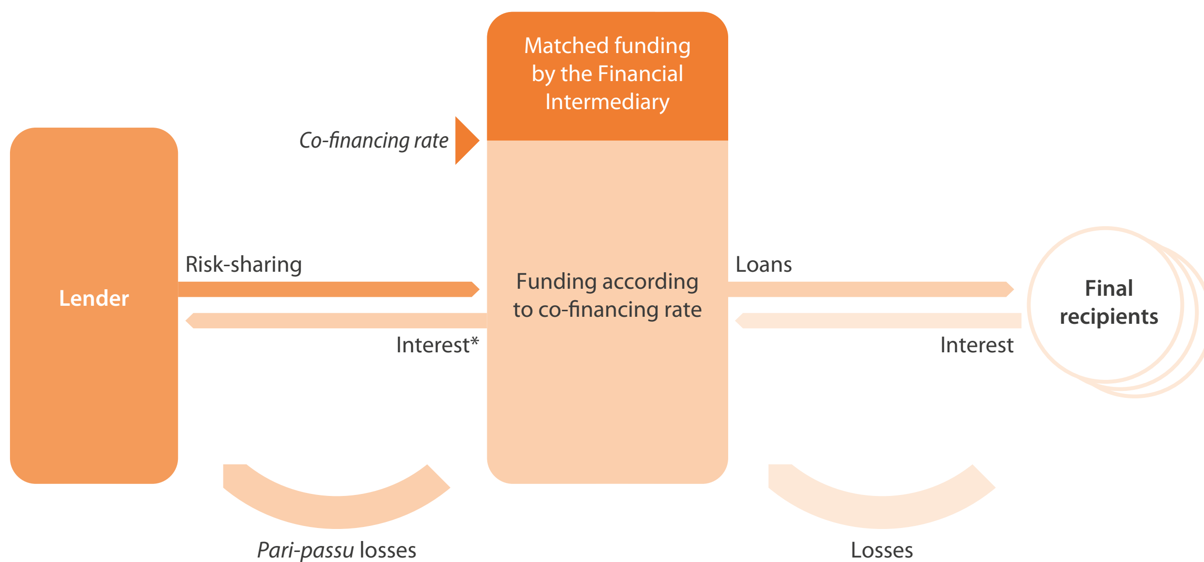
The risk-sharing loan model implies that the risk of the underlying loans to final recipients are shared between the managing authority's contribution from ERDF programme resources and the body implementing the financial instrument.

Risk-sharing loan instruments allow financial intermediaries to provide so-called soft loans to final recipients with better terms and conditions than are available in the market. Such improved conditions could include lower than standard market interest rates, longer maturity (i.e. repayment period), the possibility of grace period (i.e. repayment holidays) or reduced collateral requirements.

Better terms and conditions are possible, because the credit risk is shared by the public and private sector. In a risk-sharing loan instrument, resources contributed from ERDF programme resources and funds from the financial intermediary are pooled together providing credit risk sharing to the latter with the ultimate aim of improving access to finance to targeted SMEs. The risk would always be shared in an agreed proportion (i.e. the co-investment rate) as a way to align the interest between the parties.

In other words, the co-financing rate established for the loan instrument indicates the proportion of the risk covered by the co-investor. Consequently, the remaining part would have to be retained by the financial intermediary. For example, a co-financing rate of 70% means that in case of default, 70% of the loss incurred would be covered by the ERDF programme resources, while 30% would be a loss absorbed by the bank.

Figure 5: Portfolio risk-sharing loan model

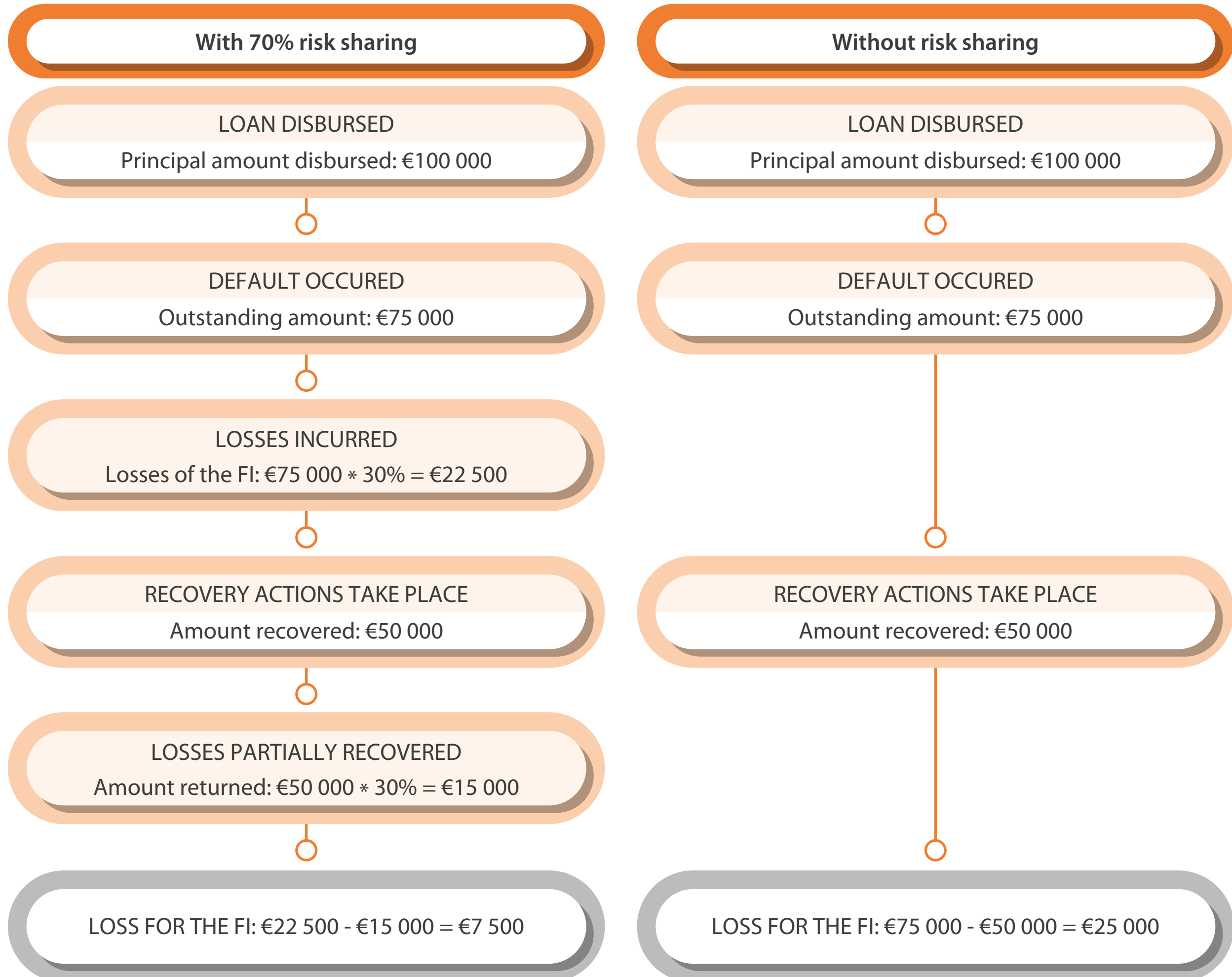


* If applicable. Contribution often priced at 0.

Loan financial instruments, by credit risk sharing, allow the banks to finance final recipients that otherwise would not receive credit, either because the risk of default of their investment project would exceed the level that the banks would be willing to take, or because they lack the necessary credit history or collateral that would be required to receive the financing.

This is because, if a default occurs at the level of final recipients, the loss to be borne by the body implementing the financial instrument can be significantly reduced as a result of the risk sharing with ERDF programme resources. The below example shows what happens in case of a default with and without the risk-sharing loan instrument. The example assumes a co-financing rate of 70%, a principal amount of EUR 100 000 disbursed to the final recipient and EUR 75 000 of which is outstanding at the time it defaulted. Due to the recovery actions, the bank was able to recover EUR 50 000.

Figure 6: Example of the consequences of default with and without risk sharing



Research and Innovation Funds in Italy, ERDF loan and equity financial instruments

The fi-compass case study on the financial instruments set up by the Italian Ministry of Universities and Research (MUR) describes how both loan and equity financial instruments were developed to support innovative companies (small and large) in Southern Italy.

ERDF resources were used to provide medium/long-term loan products of between EUR 500 000 and EUR 12 million to eligible final recipients. Flexible collateral requirements and low interest rates enable the products to be tailored to the needs of companies developing innovative products.

The case study also refers to another innovative financial instrument developed with ESF resources to provide students from the eight regions of Southern Italy, who will attend university and master programmes in Italy or in other countries, with loans to cover both tuition fees and living expenses. Loans have a duration of up to 25 years and a grace period of up to 30 months.

4.3 Layered investment platform – tranching co-investment

A more complex type of risk-sharing loan is a layered investment platform which provides a structure which enables private investors to contribute financing at a lower risk. An example of a layered investment platform can be found in the fi-compass case study Residential energy efficiency financial instruments in Lithuania.

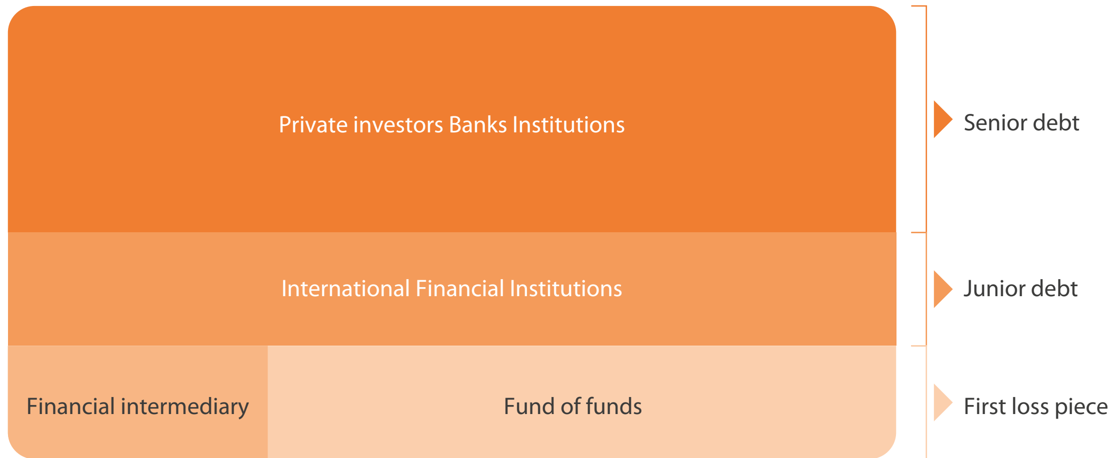
The structure of the investment platform is shown at Figure 7. It shows how the layered investment platform is made up of different tranches as follows:

- the **first-loss piece** made up of contributions from ERDF and the financial intermediary (on *pari-passu* terms). This tranche has the highest risk level since all the defaults in the underlying Modernisation Loan portfolio would first result in losses for this layer of funding;
- the **junior debt** (e.g. from International Financial Institutions). This is a lower risk layer but acts as a further credit enhancement protection for the senior debt layer; and
- the **senior debt** (e.g. from commercial banks). The lowest risk layer since any losses would only be incurred in the relatively unlikely event that the defaults in the Modernisation Loan portfolio exceeded both the first-loss piece and junior debt layers.

The tranching of the contributions enables the financial instrument to attract a range of investors with different appetite for risk and return. At the same time it allows bodies implementing the financial instrument to access greater liquidity to scale-up its operation.

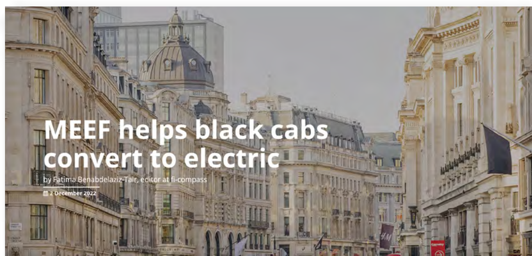
In Lithuania, the layered investment platform was developed to attract new investors into a growing market. The structure provided an opportunity for institutions to commit finance whilst at the same time benefiting from the specialist expertise of the EE market for residential properties in Lithuania of the body implementing the financial instrument.

Figure 7: The Lithuanian Leveraged Fund investment platform



Loans for larger projects (typically over EUR 25 million) may also be made through a Club deal where two or more lenders contribute to the overall financing needs of the project. In a Club deal, one lender acts as the lead arranger and enters into a loan agreement with the final recipient. The other lenders enter into a separate agreement with the lead arranger which governs their respective contributions, risk and return.

Innovative loan financing for sustainable transport



The ERDF financial instrument set up in London during 2014-2020 programming period used loan financing to support an innovative product to enable one of London's Black Cab companies to but a fleet of 30 new vehicles.

The financial instrument, The Mayor of London's Energy Efficiency Fund (MEEF), provided a loan to the fintech Zeti to enable it to implement a novel financing mechanism where the borrower pays for the actual usage of the vehicle in terms of a pence per mile basis over an agreed fleed mileage. The rate of mileage consumption determines the rate at which the loan is repaid.

4.4 Loan pricing – passing the benefit to the final recipient

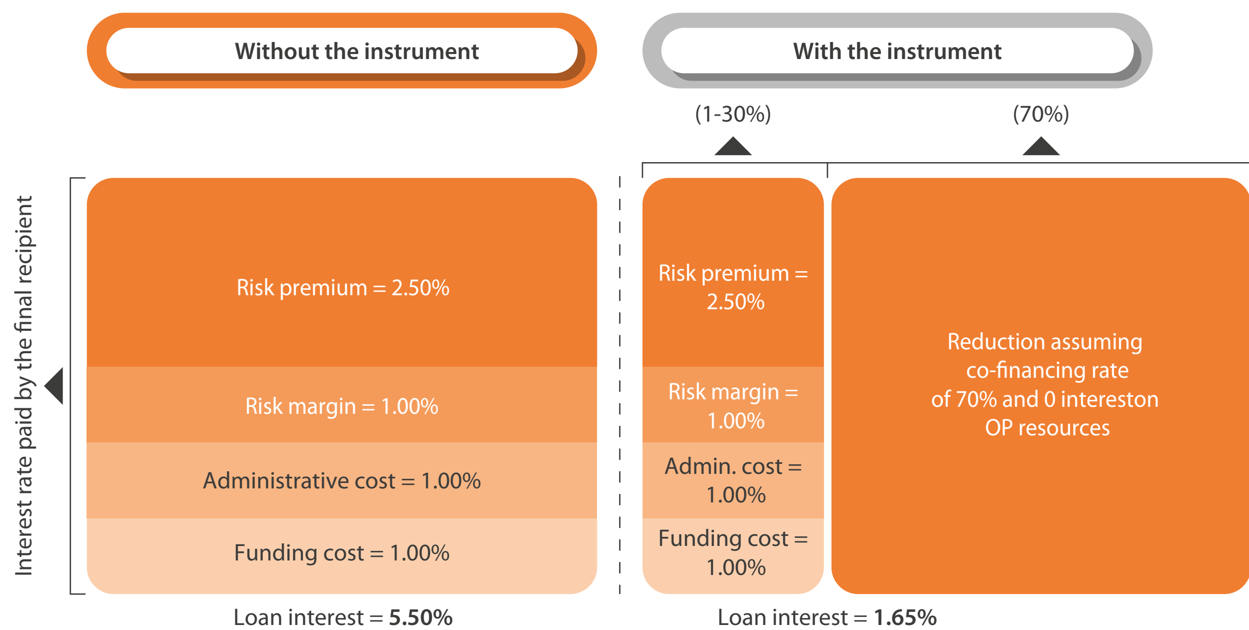
Loan financial instruments decrease the costs of financing for final recipients, allowing them to receive the financing when the standard lending conditions would not be affordable. Indeed, thanks to the loan instruments, final recipients will benefit from better terms and conditions than what they would be offered if they applied for standard market financing.

This is because a cornerstone of the risk-sharing loan instrument is the requirement that the benefit of the risk-sharing (which often includes the contribution of the co-investor provided with reduced price or free of charge) would have to be transferred entirely to the final recipients in the form of improved terms and conditions mentioned above.

In case of commercial loans, in general, an interest is composed of funding costs, administrative costs, profit margin for the bank as well as a risk premium. The latter reflects the likelihood of the borrower (i.e. the final recipient) paying the money back to the lender. The risk premium varies according to the borrower's credit history, assets used as collateral and expected cash flow.

While the body implementing a financial instrument could charge for each of these cost factors according to the market standards and internal credit risk assessments, the portion of the loan covered by the ERDF programme resources would bear a reduced cost at the level of the final recipients. Consequently, as a result of blending the rate of financial intermediary's own finance (i.e. according to market rates) and ERDF programme resources (i.e. reduced or free of charge), the interest rate charged to the final recipients would be reduced compared to the standard market rates (see Figure 8 below explaining the mechanism via an illustrative example).

Figure 8: Mechanism of interest rate reduction as a result of the transfer of benefit requirement



This approach underpins the vast majority of ERDF risk-sharing loan financial instruments, enabling the implementation of loan programmes that provide final recipients with access to low-cost loans.

IFRRU 2020 (Portugal)

IFRRU 2020 is a fund of funds launched in 2017 using EUR 102 million of ERDF and Cohesion Fund resources, among others. It has been established to fund urban renewal and energy efficiency in Portugal on behalf of eight managing authorities.

The investment strategy of the fund of funds targets the improvement of buildings that are more than 30 years old, abandoned industrial spaces and units, social housing and public space. Typically, the works will improve the general condition of the building and must include interventions to improve the energy efficiency of the building.

The financial instruments pass on the benefit of the ERDF/CF resources to the final recipient at no cost which when combined with public and private sector resources results in a below market interest rate loan being provided to the final recipient.

Another key feature of the financial instrument is the role of the municipalities. Before a project can be granted a loan from an IFRRU 2020 financial instrument, it must secure a binding opinion from the municipality where the project is situated, ensuring that the project is consistent with the strategy for sustainable urban development for the territory.

4.5 Loan financing in combination with grant

Loan ERDF financial instruments have been used in combination with grant, funded by both ERDF and national resources, in sectors including EE, SME finance and RDI. Grants can be used in a range of different ways including to open up new more risky markets to financial instruments, to fund projects with a viability gap (where the revenue/savings generated are insufficient to finance a loan to meet the total project cost), to make finance more affordable (through interest rate subsidies) and to provide technical support to project promoters.

Under Article 58(5) of the Common Provisions Regulation 2021/1060 (CPR), grants can be combined with financial instruments in a single operation, enabling the body implementing the financial instrument to deploy the grant alongside the loan, with the rules relating to financial instruments applying to the eligibility and reporting of the grant component.

Grants can be combined with loan financial instruments to meet a number of different types of needs of final recipients, allowing the product to be tailored to the local market. Typically these include:

- **Interest rate subsidies** – as Figure 8 shows the risk-sharing loan model enables a reduced interest rate to be offered to the final recipient. This can be further reduced by offering an interest rate subsidy to cover some or all of the price payable in respect of the portion of the loan not funded from ERDF programme resources;
- **Technical support grant** – the body implementing the financial instrument may pay grant to a final recipient (or to another body for the benefit of the final recipient) for the preparation and/or the implementation of the project (e.g. grant to cover the costs of an energy audit performed before and/or after the renovation works in the case of energy efficiency retrofit investment);
- **Capital grant** – where the body implementing a financial instrument provides the final recipient with a grant to meet part of the investment cost, for example where a proportion of the project is non-revenue generating. Disbursements of loan and grant may be made simultaneously or in tranches, depending on the type of project and on the final recipient's funding needs.
- **Capital rebate** – where the grant is used to repay early/write off part of the principal. This mechanism is often linked to the achievement of a specified target (for example regarding the Energy performance of the new project).
- **Convertible grant/loan** – where a grant may be converted into a loan in certain defined circumstances (or vice-versa). This may be used, for example in connection with the support of RDI projects and innovative enterprises to provide risk protection to the entrepreneur in the event the business fails.

The need for grants must be identified and justified as part of the market failure assessment at programme level and be analysed in detail in the financial instrument's investment strategy. Managing authorities will then sign one funding agreement with the body implementing the instrument covering the contributions to both the loan and grant components. Both forms of support shall be provided to or for the benefit of the final recipient, with the body implementing the financial instrument appraising and approving applications and making the combined grant and loan funding available.

Combination of financial instrument and grants

The fi-compass factsheet, published in May 2021, explores the different possibilities for combining grants with loan, equity and guarantee financial instruments.

The factsheet describes how a number of different types of grant support including interest rate subsidies, technical support, capital grant and capital rebates can be combined with loan, guarantee and equity financial instruments in a single operation. Governed by financial instrument rules, combined financial instrument-grant operations are expected to play an important part in scaling up the use of financial instruments to support cohesion policy in the 2021-2027 period. The factsheet describes the options available under the regulations and gives practical examples of how the flexibilities can be applied in practice.

4.6 Implementation of loan financial instruments

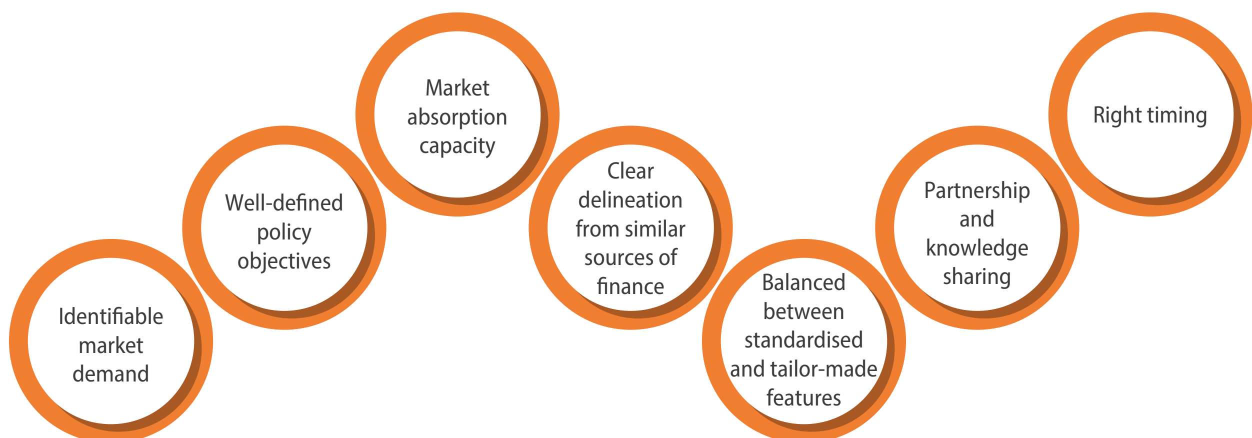
The starting point for the managing authority responsible for the implementation of the loan financial instrument is the ex-ante assessment, which will include a recommended Investment Strategy. The next stage is to identify the body that will implement the financial instrument through either a holding fund structure or a specific fund structure. The selection of the the body/bodies implementing the financial instrument will be made in accordance with Article 59 CPR and applicable public procurement rules.

Establishing the appropriate governance structure to the instrument is crucial for the successful implementation of the instrument. That could include a well-regulated monitoring committee or governance board to help the managing authorities setting up the financial instrument, including defining the terms of reference for the selection of financial intermediaries, to monitor the implementation and intervene with amendments to the investment strategy when needed.

A funding agreement is established between a managing authority and the body that implements the holding fund or between a managing authority or the body that implements the holding fund on one hand and the body that implements the specific fund on the other hand. The same financial intermediary may be the fund manager as well as a co-investor in the loan instrument. Final recipients such as SMEs apply for the loan through selected lending organisations such as commercial banks, cooperative banks, public bank or microfinance institutions. In-house specialists or external consultants/specialised agencies in partnership with the lending institutions can provide important hands-on support to the final recipients often directly, in parallel to the loan application (i.e. one-stop-shop).

For the overall success of the instrument, it should address an existing market demand based on an actual financing gap, so that there would be sufficient uptake by final recipients with viable investments. The relevance and adequacy of the proposed financial instruments should be justified by an ex-ante assessment drawn under the responsibility of the managing authority prior to the launch of the instrument. It is also important to keep it simple with respect to product features and eligibility, keeping an eye also on the right balance between the goals of achieving policy objectives and ensuring market absorption capacity.

Figure 9: Success factors



Market testing carried out before the finalisation of the product structure is also important to verify the assumptions (e.g. proposed volumes, target groups, eligibility, etc.) and market interest on the ground. It is also essential in order to avoid crowding-out the instrument by other/similar products already on the market. Clear definition of the scope of the product and the eligibility criteria based on the results of the market testing can help to prevent the potential cannibalisation of the instrument by other sources of finance.

Finding the right timing for the initiation of the instrument is also important for the overall success. The managing authorities and the implementing bodies have to account for the time required for each phase during implementation, including product design, market testing, selection of the intermediaries, disbursement of the loans, as well as the execution of the exit strategy and winding-up of the instrument. In order to maximise the uptake and effectiveness of the instrument, the managing authority should keep an eye on the planned availability of other sources of funds such as grants, with respect to the launch time.

Strong partnership and collaboration among the stakeholders (including the managing authority, the body implementing the financial instrument and lending institutions) is essential throughout the entire life cycle of the financial instrument that is from market testing all the way until the termination of the instrument. This can be achieved by early involvement of all parties in the discussions regarding product design and constant communication during product deployment regarding operational aspects of the implementation.

Knowledge sharing is an important factor for the successful implementation of financial instruments as well. In order to ease the implementation of financial instruments and to transfer the know-how to managing authorities and other stakeholders interested in using such forms of support, the EC in collaboration with the EIB launched the fi-compass platform providing a wide range of technical assistance services, including trainings, targeted coaching, publications (such as the present factsheet), exchange of best practices as well as networking events.

fi-compass Knowledge Hub – Implementation of financial instruments across consecutive programming periods

The Notes of workshop published in relation to the fi-compass Knowledge Hub on implementation of financial instruments across consecutive programming periods highlights best practice exchanged between participants in a number of key stages of the implementation process. Activities covered include the design of the instrument, selection of bodies implementing of financial instruments across consecutive programming periods the financial instruments and payments and reporting.

The Notes also consider the opportunities created by Article 68(2) CPR that allows resources from successive programming periods to be contributed to the same financial instrument and the implications this has for the implementation procedures.

In the fi-compass factsheet, Combination of financial instruments and grants, an example of the steps a managing authority should take to implement a financial instrument combined with grant was set out. It was prepared in relation to a loan financial instrument with a capital rebate to finance energy efficiency projects.

The example below describes the sort of considerations a managing authority may make when deciding how to structure the grant component to complement the loan financial instrument that will provide the bulk of the financing for the project. This is one example of an approach that may be adopted. In practice, managing authorities have the flexibility to design their interventions so as to best respond to their local market needs, as identified in their ex-ante assessment.

How to implement a financial instrument with a capital rebate in the shared management context?

Loan financial instrument combined with a capital rebate

How may a financial instrument combined with a capital rebate be implemented in practice? Let us take the example of the energy efficiency sector. In this field, capital rebates embedded in financial instruments cannot be known with certainty before renovation works are commissioned and audited. In practice, the financial intermediary may initially provide a loan covering the entire value of the investment supported by the combined financial instruments. If a grace period is foreseen to cover the construction phase, only interests may be paid during this initial phase by the final recipient.

Depending on the level of energy savings actually achieved, part of the loan may be converted into a grant and accounted as a loan write-off or pre-payment by the financial intermediary, thus reducing the latter's credit exposure to the final recipient. A revised repayment schedule of the reduced capital outstanding will then be implemented.

Two different situations may be envisaged:

- The financial intermediary may convert the share of the loan into a grant within the envelope of EU funds it manages, if it is in charge of managing both forms of support.
- The financial intermediary may also cash in the grant in case it is managed by the holding fund.

In both cases, the use of the grant to partly pay back the loan would be in line with the 2021-2027 CPR if the eligible expenditure is split between the loan and grant parts and is not declared twice for reimbursement.

The capital rebate applied to the financial intermediary's part of a risk-sharing loan could also be financed from the loan reflows already paid back to the financial intermediary if any. Otherwise, a part of the Funds (e.g. ERDF) may be set aside to compensate the financial intermediary in case the capital rebate exceeds the part of the loan co-financed by the EU funds and affects the financial intermediary own funds.

An option used by some public development banks is to apply the rebate to the last capital repayments and reduce the loan tenor accordingly. Under this scheme, the final recipient continues to pay back the loan as initially agreed until it is fully amortised, which occurs earlier thanks to the capital rebate. Should banks not find capital rebates attractive against their loans as they would reduce their return on investment, an option could be for them to include in their proposals early redemption fees for parts of the loan that benefit from the rebate. The other option would be for banks to charge a premium on all loans to compensate for the potential rebates. However, banks may accept this high probability of write-off or early repayment as a key feature of the combined financial instrument and consider it anyhow attractive as it may open new markets and (significantly) increase the demand for financing on the ground while reducing credit risks.

From an eligibility point of view, the overall sum eligible for repayment from the EU budget would remain the same before and after the capital rebate, as a part of the loan would be transformed into a grant but without any increase or reduction of the overall support amount at the end of the period. The managing authority will maintain separate records for both forms of funding when declaring eligible expenditure to EC.

05 Loan financial instruments: an ERDF perspective

5.1 Policy framework for ERDF loan financial instruments

For the 2021-2027 period, more than EUR 370 billion has been allocated to economic, social and territorial cohesion policies in the EU. To facilitate further the uptake of financial instruments in all policy areas, the Commission has simplified the rules related to financial instruments and introduced enhanced flexibility, broader eligibility and increased opportunity for combination with grants.

The ERDF Regulation[10] for the 2021-2027 period defined the following specific Policy Objectives (PO) for the ERDF and CF:

- **PO1:** a more competitive and smarter Europe by promoting innovative and smart economic transformation and regional ICT connectivity;
- **PO2:** a greener, low-carbon transitioning towards a net zero carbon economy and resilient Europe by promoting clean and fair energy transition, green and blue investment, the circular economy, climate change mitigation and adaptation, risk prevention and management, and sustainable urban mobility;
- **PO3:** a more connected Europe by enhancing mobility;
- **PO4:** a more social and inclusive Europe implementing the European Pillar of Social Rights;
- **PO5:** a Europe closer to citizens by fostering the sustainable and integrated development of all types of territories and local initiatives.

Environmental risk loan (Czechia)

The loan instrument has been set up by the Ministry of Environment with an EUR 18.5 million financial allocation and managed by th State Environmental Fund (SEF) that contributed EUR 6 million of its own resources for a grant component.

The objective of the instrument is to address, reduce and manage environmental risks by tackling the main barriers of investments related to the very low rate of return.

Eligible investments include:

- Refurbishment of cooling systems, including ice hockey rinks;
- Reconstruction of facilities producing hazardous chemical substances;
- Reconstruction and purchase of technologies for monitoring of industrial pollution;
- Construction and reconstruction of installations for the storage of hazardous chemical substances.

10 Regulation EU 2021/1058

The final recipients are enterprises as well as public entities, such as municipalities or municipal enterprises, except for projects located in the City of Prague.

The minimum level of the loan is 35% and it can reach up to 100% of the eligible expenditure. It can be combined with a grant for up to 25% of the investment, provided that the overall support cannot exceed 100% of the investment and the State aid rules are respected.

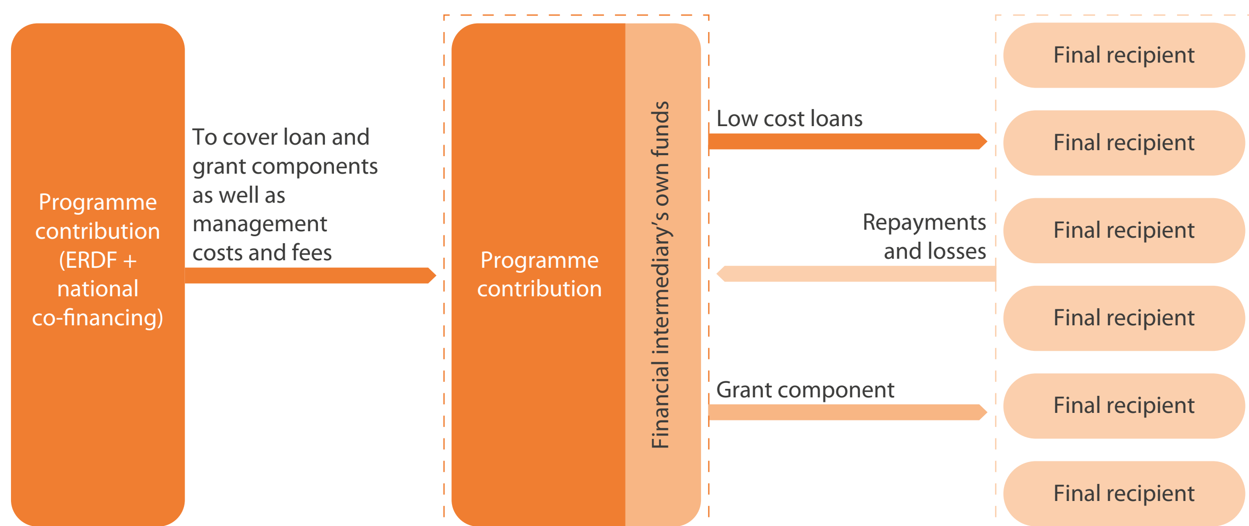
Financial instruments co-funded by the ERDF can be used to support a wide range of projects. However, the majority of the investments supported by financial instruments are expected to target the first two Policy Objectives, with a growing number of financial instruments also expected to be orientated towards PO5, supporting urban development and initiatives including the New European Bauhaus.

5.2 Loan financial instruments to support energy efficiency

The fi-compass model for a financial instrument with a grant component to support energy efficiency describes how loan financial instruments with a grant component can be used to finance EE projects. The model financial instruments are intended to provide a non-exhaustive insight into the potential for managing authorities to use the new flexibilities in Article 58 CPR. Several practical solutions are highlighted in the model, for example regarding the management of the different forms of support by a financial intermediary and/or holding fund manager; the mechanisms to be deployed in relation to the disbursement of the grants such as capital rebates; and reporting and monitoring arrangements.

The model financial instrument, which is shown in Figure 11, takes the form of a combined loan and grant financial instrument to be managed by the body implementing the financial instrument on behalf of a managing authority, acting either directly or through a Holding Fund. The EE financial instrument would be established under Policy Objective 2 a greener, low-carbon transitioning towards a net zero carbon economy and resilient Europe.

Figure 10: The fi-compass model EE financial instrument



The financial instrument is designed to provide finance to individuals, public bodies and private organisations to carry out the renovation of eligible buildings to make them more energy efficient. The body implementing the financial instrument is entrusted to deploy grant in combination with the loan and the model provides different options that managing authorities may choose to adopt to meet the needs of their local market. Under the model grants can be used to finance activities including technical support to building owners; an interest rate subsidy to reduce the cost of borrowing; a capital rebate that repays part of the loan on achievement of specified energy efficiency outcomes; and a capital grant to extend financing to low-income individuals.

The model financial instrument includes a description of the different types of eligible activity to illustrate the kind of interventions managing authorities may wish to adopt under their Investment Strategy following the recommendations of their own ex-ante assessment. An illustrative example of grant commitments are also included as a guide for promoters of the financial instrument. The model highlights several different approaches to demonstrate State aid compliance.

fi-compass success story – Energy efficiency financial instruments in Lithuania

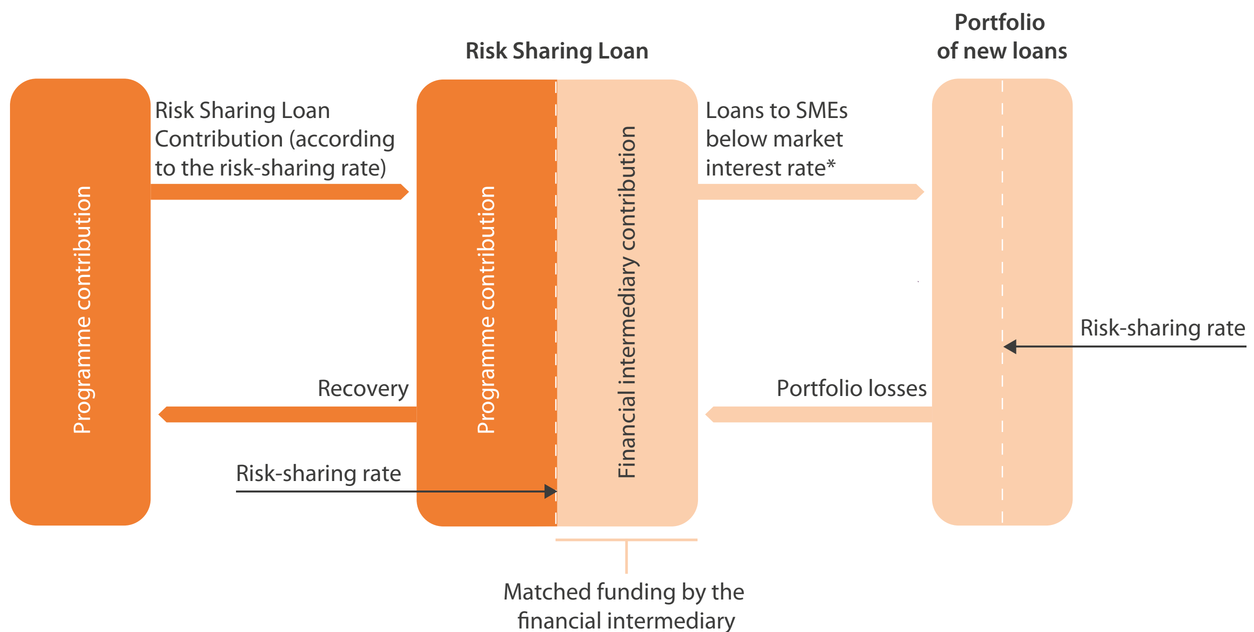
The fi-compass video case study of the EE financial instrument in Lithuania show how the ERDF backed loans, combined with grant, have helped improve the homes of thousands of people.

The video includes testimony from representatives of the managing authority, the Holding Fund manager, the EIB (holding fund manager), the body implementing the specific fund and residents that have benefited from the low-cost, long-term loans provided through the financial instruments.

5.3 Loan financial instruments to support SMEs

The Risk Sharing Loan 'off-the-shelf' Risk-Sharing Loan financial instrument[11], published by the European Commission in the 2014-2020 programming period, provides a simple structure to combine resources from the ERDF programme and the financial intermediary to support financing to SMEs.

Figure 11: The model portfolio risk-sharing loan financial instrument



Note: *Full benefit of interest rate is passed to SMEs

The model Risk Sharing Loan financial instrument is shown in Figure 11. Financial intermediaries are entrusted to build up a portfolio of newly originated loans and participate in the losses/defaults and recoveries on the SME loans in this portfolio on a loan-by-loan basis and in the same proportion as the programme contribution in the instrument. Financial intermediaries are required to retain minimum 25% of the total financing commitment within the loan instrument.

The financial intermediaries must fully pass on the financial benefit of the public contribution to the final recipients. The transfer of benefit shall be evidenced in the pricing policy, whereby the overall interest rate charged on loans shall be reduced proportionally to the allocation provided by the public contribution.

11 Commission Implementing Regulation (EU) No 964/2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments

‘La Financière Région Réunion’ (France)

The managing authority of the La Réunion region of France entrusted the EIF to manage the fund of funds ‘La Financière Région Réunion’. The fund of funds was set up in 2017 with a mandate to implement two financial instruments (a loan fund and an equity fund) to support SMEs.

The loan fund is a risk-sharing instrument which seeks to leverage the fund of funds contribution of EUR 37.2 million with EUR 24.8 million of resources contributed by the selected financial intermediary Banque Française Commerciale Océan Indien. The product (i-RUN) is designed to allow locally-based SMEs to access financing more easily and at better terms.

In addition to the setup of the financial instruments, the region established a capacity building programme which has aimed to raise awareness of financial instruments and to support SMEs to access the finance.

5.4 The New European Bauhaus Territorial Development Model financial instrument

Urban development has been an important sector for ERDF loan financial instruments since the JESSICA (Joint European Support for Sustainable Investment in City Areas) initiative in the 2007-2013 programming period. The New European Bauhaus Territorial Development Model (NEB TDM) financial instrument[12] that was published by the European Commission in June 2022, builds on the experience gained in the sector to provide a template for financial instruments to support the New European Bauhaus[13] initiative of the European Commission.

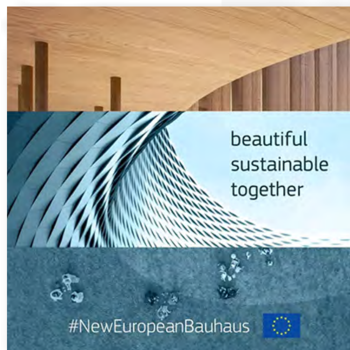
The model financial instrument, which is shown at Figure 12, provides a flexible framework to be tailored by managing authorities to support projects that reflect the NEB core values of sustainability, inclusivity and aesthetics.

The NEB TDM is designed to provide loan financing in combination with grant to public and private project promoters. Similar to the EE model financial instrument, the grant may be deployed to fund technical support, capital grant/rebate and interest rate subsidies. The model also proposes a ‘one-stop-shop’ resource to be provided by the body implementing the financial instrument to support the development of a pipeline of bankable eligible projects.

12 COMMISSION STAFF WORKING DOCUMENT New European Bauhaus territorial development model (NEB TDM) financial instrument Brussels, 17.6.2022 SWD(2022) 172 final.

13 New European Bauhaus: beautiful, sustainable, together. (europa.eu).

The New European Bauhaus – beautiful, sustainable, together



The European Commission's New European Bauhaus brings a cultural and creative dimension to the European Green Deal to strengthen sustainable innovation, technology and economy.

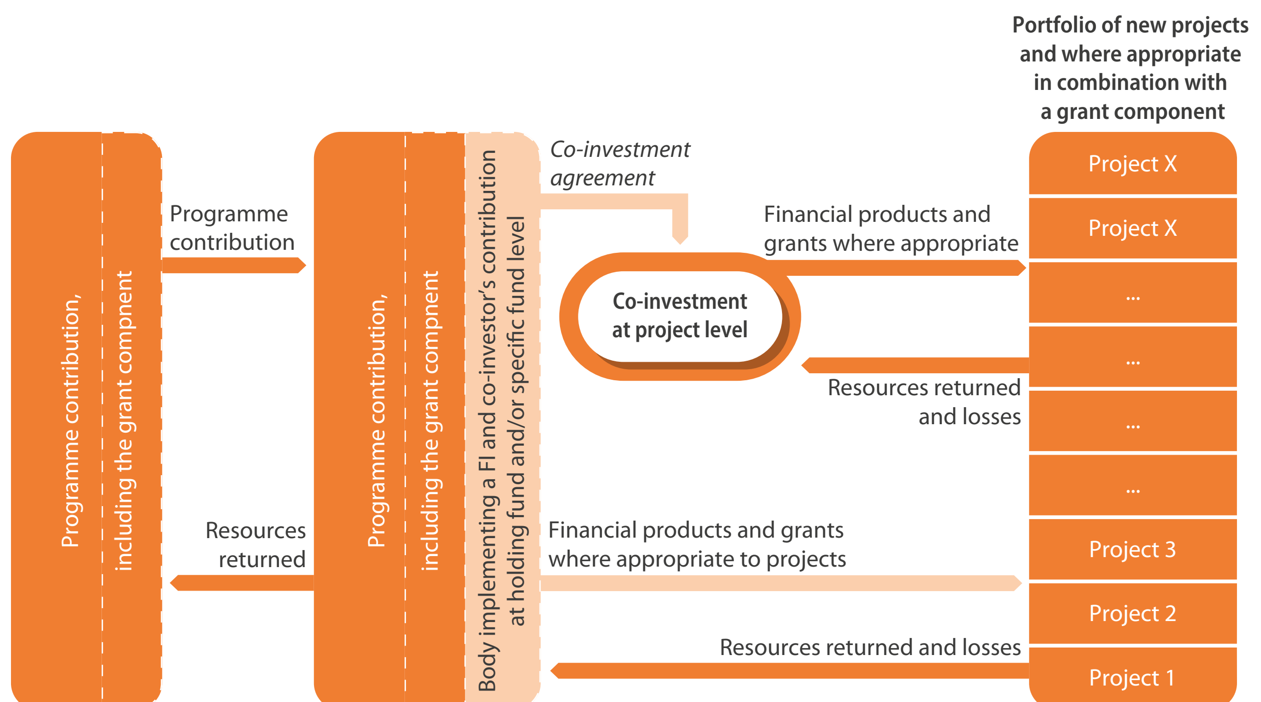
A triangle of three inseparable core values guides the NEB:

- **Sustainability**, from climate goals to circularity and biodiversity;
- **Aesthetics**, quality of experience and style, beyond functionality; and
- **Inclusion**, including accessibility and affordability.

The New European Bauhaus territorial development model (NEB TDM) financial instrument has been published as a Commission Staff Working Document. The model financial instrument aims to provide managing authorities implementing cohesion policy programmes with the building blocks that they could use to set up and implement a financial instrument supporting the New European Bauhaus projects in the 2021-2027 period based on the CPR.

ERDF loan financial instruments have been used to support urban development projects through longterm loans, in some cases at reduced interest rates and/or collateral requirements. The NEB TDM reflects this, together with highlighting the new opportunities to combine the loan with grants under Article 58(5) CPR. In addition, the model recommends extended governance options to ensure NEB expertise is harnessed at the level of the financial instrument through the composition of an Investment Advisory Board and/or through the body implementing the financial instrument.

Figure 12: The New European Bauhaus Territorial Development Model financial instrument



As well as providing a framework for managing authorities to use in the development of their Investment Strategy, the NEB TDM includes guiding principles for assessing projects' compliance with the NEB, with illustrative questions to be used in assessing compatibility with the NEB's core values.

Urban Development within a multi-sector fund of funds (Bulgaria)

A fund of funds was set up by the Bulgarian government to manage 13 different financial instruments on behalf of five managing authorities with a total financial size of EUR 550 million, using resources from five different EU funds.

Through the establishment of the FoF, the Bulgarian government aimed to secure the efficient and sustainable management of the public resources, achieve economies of scale and build professional expertise at the national level in the management of financial instruments.

Urban development is the focus of the three risk-sharing loan instruments established under the Regions in Growth Operational Programme. An innovative structure is employed in order to mobilise private sector co-investment alongside approximately EUR 163.7 million of ERDF programme resources. This is achieved through the provision of an embedded guarantee that uses an additional ca. EUR 16 million of ERDF programme resources to mobilise additional private investment.

5.5 Loan financial instruments in other sectors

With respect to the renewable energy sector, studies have shown[14] that the market failure is more elevated for less established renewable energy sources such as geothermal, solar, thermal, ocean energy and biofuels, as they are associated with significantly higher risks due to less tested business models and technologies. At the same time, they are generally characterised by capital intensity and uncertain return on investment. Therefore, private funding is rather limited in these sub-sectors, which creates market opportunities for financial instruments. Within these sub-sectors, loan instruments can help opening lending possibilities in the private sector.

Within the environment sector, investment areas related to municipalities, such as water services, waste treatment, air quality and flood risk prevention, do not generate direct streams of revenues and generally need to wait many years to break even. Under such circumstances, loans with longer maturity with preferential conditions could offer a veritable solution. It can be combined with a grant component that could cover the infrastructure connection costs in smaller municipalities in remote areas. Moreover, in the next programming period, capital rebate becomes a new option for the grant combination, whereby the municipalities could receive a type of bonus at the end of the investment's timeline if the project meets certain financial and environmental criteria defined on the outset.

14 fi-compass (2021): Stocktaking study on financial instruments by sector.

In the ICT sector, broadband infrastructure projects in sparsely populated areas are characterised by high investment costs per capita. Financial instruments providing loans, potentially in combination with grants, can help make these projects more bankable and address the high risks with these investments. For example, the grant component could be used to connect the sparsely populated areas to the infrastructure, while the loan would finance the other services once the connection is established.

In the transport sector, loan financial instruments could provide the critical mass for smaller municipalities by aggregating their projects that would not be able to receive the necessary financing in acceptable conditions on their own. This way, via financial instruments, these municipalities can receive loans with improved financing conditions, with longer maturity and lower interest rates. The financing can be combined with grants to both address viability issues and provide additional project development and implementation capacity.

The financing needs as well as the scope for public intervention related to RDI projects in the SME sector depends on the development stage of the company and of the project. Grants represent the main source of support during the initial phase, when the project does not generate revenues. Seed loans provided by ERDF financial instruments managed by specialist institutions can provide finance to start-up companies prior to commercialisation as part of an integrated financing package to support RDI. More generally, financial instruments become relevant when an innovative project reaches its commercialisation phase. ERDF-funded loan products providing co-financing to the banks can unlock access to private sector financing to support the delivery of the new product to the market. Such intervention is deemed reasonable as long as the RDI project has not reached its market maturity, when it can already be fully financed by the private sector without incentives from the public sector.

Broadband loan instrument (Poland)

The financial instrument for the deployment of broadband infrastructure was implemented by the Department for Digital Development of the Polish Ministry of Development Funds and Regional Policy, acting as managing authority, together with the Poland's national promotional bank, Bank Gospodarstwa Krajowego (BGK) acting as fund of funds manager.

The initial size of the financial instrument was EUR 270 million, EUR 230 million of which was contributed from ERDF funding from the OP (without public national co-financing) together with financial intermediaries' contribution amounting to at least 15% to the financial instrument. Later in 2018, BGK reduced the allocations to the loan instrument to EUR 145 million and allocated the remaining amounts to a new guarantee instrument addressing the same market.

The loan can cover up to 95% of the eligible cost of the projects with the remaining amount to be provided by the network operator. The ESIF part of the loan was priced at 0.25% per annum and no fees were charged.

The financial instrument was complementary to existing grant schemes under the OP. The scope of eligibility is significantly wider than for grants covering project preparation cost, active and passive infrastructure, investment into connection to the client and working capital necessary for realisation of the project.

Further information

Set out below is a list of fi-compass resources that can be found on our fi-compass website (www.fi-compass.eu) and provide additional information on loan financial instruments established with EU shared management funds.

Factsheets, brochures and studies

Commission Staff Working Document, The New European Bauhaus Territorial Development Model financial instrument

fi-compass Knowledge Hub - Implementation of grants and financial instruments combined in a single operation

fi-compass Knowledge Hub - Implementation of financial instruments across consecutive programming periods

fi-compass Knowledge Hub - Audit and control of financial instruments 2014-2020

fi-compass Knowledge Hub - Audit of financial instruments in the 2021-2027 programming period

fi-compass Knowledge Hub - Combination of financial instruments and grants under shared management funds in the 2021-2027 programming period

fi-compass Knowledge Hub - Selection of financial intermediaries

fi-compass Knowledge Hub - State aid

fi-compass Knowledge Hub - fi-compass Funding Agreement

Model for financial instrument with a grant component to support energy efficiency

Combination of financial instruments and grants

The potential for investment in energy efficiency through financial instruments in the European Union

European, Structural and Investment Funds (ESIF) and Energy Performance Contracting (EPC)

Stocktaking study on financial instruments by sector – Executive summary

Stocktaking study on financial instruments by sector - Environmental risk loan in Czechia

Stocktaking study on financial instruments by sector - Final report

Stocktaking study on financial instruments by sector - The infrastructure fund of Greece

Stocktaking study on financial instruments by sector - The Polish broadband loan instrument

Stocktaking study on financial instruments by sector - The use of financial instruments in the 'Environment' sector

Stocktaking study on financial instruments by sector - The use of financial instruments in the 'Renewable Energy' sector

Stocktaking study on financial instruments by sector - The use of financial instruments in the 'Information and Communication Technologies infrastructure' sector

Stocktaking study on financial instruments by sector - The use of financial instruments in the 'Research, Development and Innovation in Small and Medium-sized Enterprises' sector

Stocktaking study on financial instruments by sector - The use of financial instruments in the 'Environment' sector

Gap analysis for small and medium-sized enterprises financing in the European Union

Financial instrument products

Case studies

ERDF renewable energy loans in Pomorskie, Poland

Slovak Investment Holding – multi-sector financial instruments in Slovakia

Research and Innovation Funds in Italy – ERDF loan and equity financial instruments

FMFIB: Fund Manager of Financial Instruments in Bulgaria – a multi-sector fund of funds

Residential energy efficiency financial instruments in Lithuania

FOSTER TPE-PME-AGRI a new generation multi-sector fund of funds, Occitanie, France

La Financière Région Réunion - Financial instruments to support SMEs, France

Financial instruments for urban development in Portugal – IFRRU 2020 case study

Energy Savings in Existing Housing Programme, Greece

Loans and guarantees for SMEs - The JEREMIE Initiative in Cyprus

'TEPIX Business Restart' Action, Greece

Innovation Fund, East Netherlands

Loan fund INNODEM2 - Belgium

JEREMIE in Extremadura - Spain

Ex-ante assessment for financial instruments in Scotland

London Green Fund

Urban Development Fund in Pomorskie

Renovation loan programme

Videos

Financial instruments for innovation in La Réunion

Financial instruments in action: renewable energy transition

ERDF financial instruments in action: Urban Development in Bulgaria

Combination of financial instruments and grant

Energy efficiency in housing

Financial instruments in action: green and efficient energy for Sportainment Centre

Financial instruments in action: an old cinema becomes an indoor playground

Financial instruments in action: Urban Renewal, Waldorpstraat

Financial instruments in action: Solar energy to power a football club

Financial instruments for urban development in Portugal – IFRRU 2020 video case study

ESIF financial instruments in Italy - MIUR

Energy efficiency loans for Lithuanian homes

Blogs and podcasts

MEEF helps black cabs convert to electric

ERDF financial instruments help Italian social cooperative cut bills

Green energy courtesy of your bio-waste

Comfort and savings for low-income households in Greece

Energy-saving renovation: good for the planet…and for the wallet

IFRRU 2020: where there is a will, there is a way

Energy transition in The Hague

Episode 11: The New European Bauhaus Model Territorial Development financial instrument

Episode 10: Model loan and grant financial instrument for energy efficiency

Episode 4: Financial instruments help The Hague meet ambitious sustainability goals

Showcase videos

Sustainable Cities Fund: Future proofing cities in Bulgaria

INVEGA: Better access to finance for innovative and social enterprises

IFRRU 2020: A second life for Portugal's historical landmarks

NRB: Supporting innovation and SMEs in Czechia

HBOR: ESIF Growth and Development Loans

VIPA: Renovation is the new Lithuanian fashion

A video story from Bulgaria: three urban development projects

A video story from West Pomerania, Poland: Old Slaughterhouse

A video story from the Emilia-Romagna region in Italy: Metalcontrol

A video story from the Emilia-Romagna region in Italy: CIDAS

A video story from Croatia: Termostroj

A video story from Croatia: Denona

5 SMEs in Croatia benefitted from HAMAG-BICRO's ESIF co-financed small loans and micro loans

A video story from Italy: Gomedia Satcom

A video story from the Czech Republic: 'SWN Moravia supported by ČMZRB's Energy Savings programme'

A video story from the Czech Republic: 'Vranov Beach Holiday Park'

A video story from Portugal: 'IFRRU 2020'

Valetta Design Cluster

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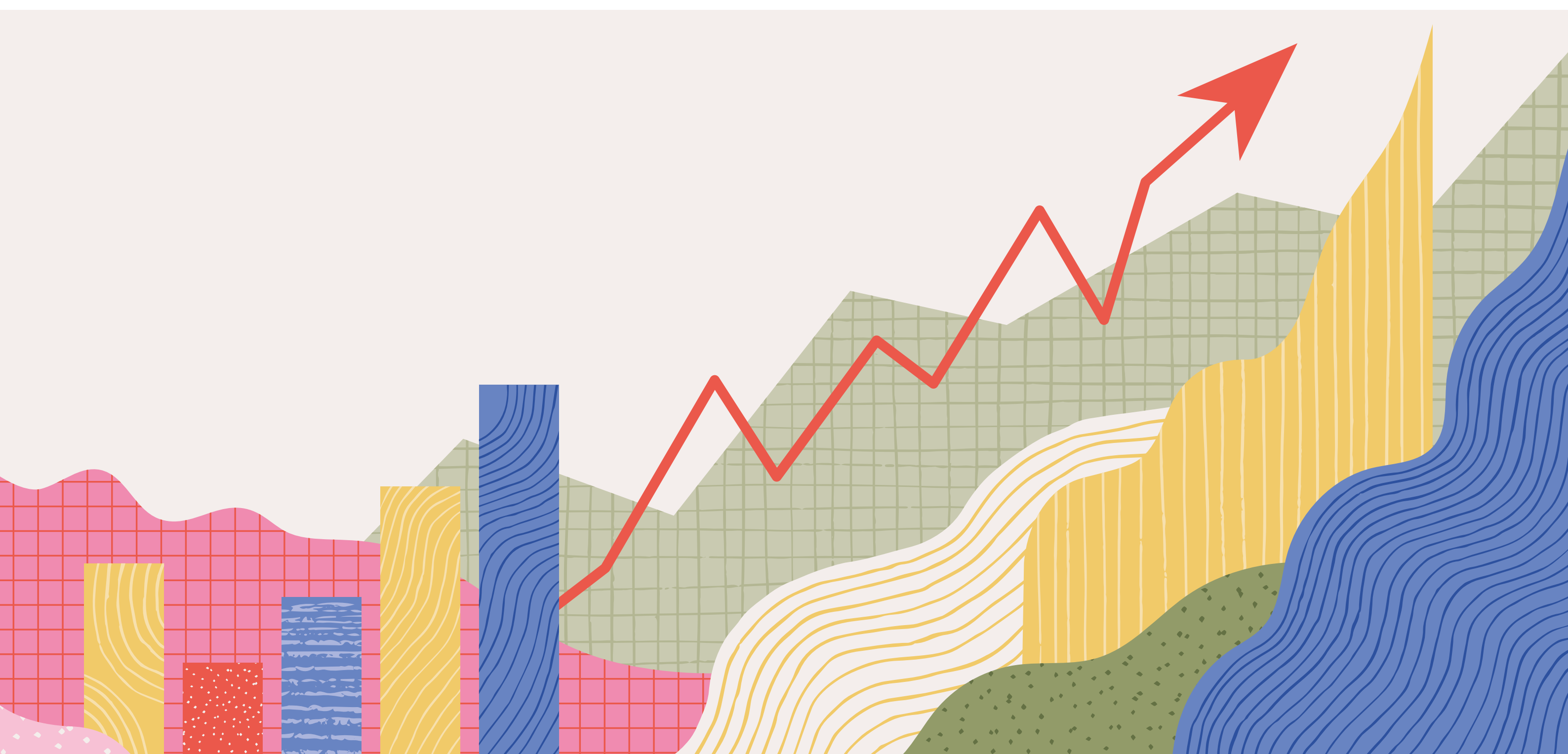

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